
OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Review of FY 2011 General Fund Year-End Revenue Projections Report

OVERVIEW

On November 29, 2010, the Financial Management Department issued the FY 2011 General Fund Year-End Revenue Projections Report, presenting year-end projections for a selection of major General Fund revenues based on actual receipts data for the first four months of the fiscal year. The report will be discussed at the December 1, 2010 Budget & Finance Committee meeting. This report is subsequent to a preliminary General Fund Major Revenues Update Report, released on September 23rd, that was presented to the Budget & Finance Committee on September 29, 2010.

The IBA has reviewed the FY 2011 General Fund Year-End Revenue Projections Report in light of current available economic data, actual year-to-date revenue performance, and unaudited FY 2010 year-end performance data. In general, the IBA assesses that the year-end projection adjustments are appropriate. In this report, our review of the major General Fund revenue projections will be discussed in further.

FISCAL/POLICY DISCUSSION

In the FY 2011 General Fund Year-End Revenue Projections Report, the adjustments to major General Fund revenues comprise a net increase of \$8.6 million. This amount is \$8.2 million more than the \$0.4 million reported in the preliminary year-end projections update released at the end of September. The current \$8.6 million modification is comprised of a downward adjustment in property tax revenue of \$5.4 million and motor vehicle license fees (VLF) of \$0.7 million, that is more than offset by a positive variance

in sales tax, TOT and safety sales tax, of \$13.1 million, \$1.5 million, and \$0.1 million, respectively. The table below compares the FY 2011 Adopted Budget and Financial Management's projections in September and November over unaudited FY 2010 actuals.

General Fund Revenue (in millions)

GF Revenue	FY 2010 Actuals (Unaudited)	FY 2011 Adopted Budget	FY 2011 September Projection	FY 2011 November Projection
Property Tax	\$ 391.0	\$ 390.1	\$ 387.9	\$ 384.7
<i>Growth Over FY 2010</i>		<i>-0.2%</i>	<i>-0.8%</i>	<i>-1.6%</i>
Sales Tax	\$ 186.1	\$ 187.5	\$ 189.5	\$ 200.6
<i>Growth Over FY 2010</i>		<i>0.8%</i>	<i>1.8%</i>	<i>7.8%</i>
TOT	\$ 64.8	\$ 66.1	\$ 66.7	\$ 67.6
<i>Growth Over FY 2010</i>		<i>2.0%</i>	<i>2.9%</i>	<i>4.3%</i>
Franchise Fees	\$ 67.0	\$ 67.2	\$ 67.2	\$ 67.3
<i>Growth Over FY 2010</i>		<i>0.3%</i>	<i>0.3%</i>	<i>0.4%</i>
Safety Sales Tax	\$ 6.3	\$ 6.3	\$ 6.3	\$ 6.4
<i>Growth Over FY 2010</i>		<i>-0.3%</i>	<i>0.0%</i>	<i>1.6%</i>
Property Transfer Tax	\$ 5.1	\$ 4.7	\$ 4.7	\$ 4.7
<i>Growth Over FY 2010</i>		<i>-8.2%</i>	<i>-7.8%</i>	<i>-7.8%</i>
Motor VLF	\$ 4.0	\$ 3.1	\$ 3.1	\$ 2.5
<i>Growth Over FY 2010</i>		<i>-22.5%</i>	<i>-22.5%</i>	<i>-37.5%</i>
Total GF	\$ 724.3	\$ 724.9	\$ 725.4	\$ 733.6

In addition to changes in the year-end revenue projections, the report provides information regarding an anticipated (\$2.0) million personnel expenditure adjustment related to a discovered over-estimate of vacancy savings within departments' FY 2011 budgets. The calculated (\$2.0) million impact is just preliminary at this time, in that it only relates to over-estimates in the Library and Park and Recreation Departments. The full assessment of this issue across departments will be provided in the FY 2011 Mid-Year Budget Monitoring Report, which is expected to be released on February 23, 2011.

As discussed in our report on the FY 2011 Proposed Budget, we noted that the methodology for determining the FY 2011 vacancy factor for departments was changed due to the features of the OneSD system. While the total vacancy savings for all General Fund departments for the FY 2011 Budget is lower than the prior year, several departments have been impacted

more significantly, especially Park and Recreation and Library, whose vacancy savings doubled and tripled, respectively. At that time, our office heard from City departments that many positions determined to be vacant during the budgetary review, and thus unfunded, had since been filled, and we expressed concern during the budget review that this could hamper the ability of departments to achieve these budgeted savings during the fiscal year.

Economic Outlook

The improvements in some of the major General Fund revenues is occurring in the backdrop of overall improvements in the economy, although these improvements have been modest, with a risk of setbacks. In September 2010, the National Bureau of Economic Research declared that the national recession, beginning in December of 2007, ended in June of 2009. Since the third quarter of 2009, the U.S. Gross Domestic Product (GDP), one of the broadest measures of the health of the national economy, has increased by an average seasonally adjusted annual rate of 2.9% (including the most recent third quarter estimate). According to the most recent estimate, GDP increased by an annual rate of 2.5% in the third quarter. Despite the end of the recession, and recent signs of economic improvements, economists forecast a slow recovery for the remainder of 2010 and in 2011.

Locally there are indications of a recovery, albeit a slow one. The San Diego County October unemployment rate fell to 10.2% from 10.7% in September, also showing a decline over the October 2009 rate of 10.6%. Despite these improvements, the unemployment rate remains high with the most recent May 2010 San Diego Economic Forecast by Beacon Economics forecasting continued high employment, with modest improvements for the remainder of 2011 and beyond. According to the Beacon Forecast, other economic indicators will see improvement, with some slowing in the remainder of FY 2011. Regional personal income will see improvements with an annual growth rate of 3.54% in the second quarter of FY 2011, up to 4.66% in the fourth quarter. Taxable sales will peak during the second quarter of FY 2011, with continued growth, though at a slower pace, in the latter half of the fiscal year. In the residential housing market, home values are expected to flatten, with a continued decline in home sales through this fiscal year. Growth in the major General Fund revenues such as property tax, sales tax, and TOT, will mimic the pace of this overall recovery.

Continued high unemployment, stalled business investments due to economic uncertainty, poor credit availability, and waning consumer confidence, could continue to dampen, and possibility undermine the current economic recovery. Due to this, some economists are uncertain of its stability.

Property Tax

The new year-end projection for Property Tax is \$384.7 million. This is \$5.4 million less than the Adopted Budget of \$390.1 million, and represents an additional decline of \$3.4 million from September projections of \$387.9 million. This adjustment represents a 1.6% decline over FY 2010 unaudited actuals.

The current property tax projection adjustment is appropriate in further accounting for the impact of a 1.47% decline in the City's 2011 Assessed Valuation (AV) as was reported by the County Assessor's Office after the adoption of the FY 2011 Budget. Despite increases in prices for homes sold in 2009¹, the FY 2011 property tax roll was negatively impacted given that homes previously sold during the peak of the market between 2003 and 2007 were newly assessed for less. In addition to these value declines, an applied CCPI of -0.2 lowered the value of approximately 70% of the properties within the City. These factors, in conjunction with others relating to reassessments, downward pricing pressure in the market due to foreclosures and short sales, and a weakened commercial real estate market, contributed to negative AV growth.

Previously, as discussed in IBA Report 10-37, the IBA had concerns with the FY 2011 Adopted Budget for property tax due to the risk of additional declines over projection related to negative growth in the City's AV. The new projection, in demonstrating a further growth reduction in FY 2011 performance over FY 2010, addresses our expressed concerns.

The adjusted property tax projection is also based on the assumption that trends in refund reductions and higher collection rates experienced in FY 2010, will take place in FY 2011. There is uncertainty regarding whether these trends will duplicate themselves in FY 2011. A decrease in the property tax collection rate to that seen in previous years before FY 2011, or refunding activity matching FY 2010, could lead to additional negative adjustments to the property tax projection over the course of the year.

Sales Tax

The new year-end projection for sales tax is \$200.6 million. This is \$13.1 million more than the Adopted Budget of \$187.5 million, and represents an additional increase of

¹ Property tax collections for FY 2011 are based on assessed valuations on or around January 1, 2010, which reflects the market activity in calendar year 2009.

\$11.1 million from September projections of \$189.5 million. This adjustment represents an increase of 7.7% over FY 2010 unaudited actuals. The sales tax projection has increased over budgeted levels to account for gains in performance at the end of FY 2010 and the first quarter of the fiscal year. Of the \$13.1 million increase, \$4.6 million is due to a triple-flip payment above that forecasted in the budget, and \$8.5 million is related to current sales tax performance above budget. Performance for future months is forecasted at 0% growth over FY 2010 actuals in the projection.

The San Diego Beacon Economics forecast for economic indicators impacting sales tax performance supports continued growth in sales tax performance for the fiscal year. Unemployment is forecast to see moderate improvements for the rest of the fiscal year, dropping to 9.65% by the fourth quarter. Taxable sales growth is anticipated to continue, with a slowing in the latter half the year, with personal income growth expected to improve, as compared to negative growth in the previous year. While this forecast can lead to optimism, high employment, low consumer confidence, and a challenging credit market all loom as factors that can undermine improvements.

A continuation of the performance seen in sales tax in the first quarter of this year would improve the sales tax projection by even greater than the \$13.1 million. Due to the risks to the current recovery's stability, it is appropriate not to increase the sales tax projection further until additional performance data is available in future months.

Transient Occupancy Tax (TOT)

The new year-end projection for General Fund TOT is \$67.6 million. This is \$1.5 million more than the Adopted Budget of \$66.1 million, and represents an additional increase of \$0.9 million from September projections of \$66.7 million. The adjustment represents an increase of 4.3% over FY 2010 unaudited actuals.

TOT collections for the first quarter of the fiscal year have demonstrated significant improvements over previous year performance and budgeted expectations. In the first quarter of FY 2011, occupancy and average daily rates (ADR) have seen growth over the previous year of 6.0% and 1.0%, respectively. Per the San Diego Convention and Visitor's Bureau September 2010 Quarterly Travel Forecast, occupancy and ADR growth will continue through FY 2011, supported by growth in overnight stays as business and consumer travel improves, with business travel contributing to a majority of the growth. The growth in overnight stays is forecasted at 6.1% for 2010, with a slowing of growth in 2011 of 2.0%. This continued improvement in TOT performance as forecast will lead to additional improvements in TOT receipts.

As is the case with the sales tax projection, caution is being exercised in adjusting the projection for future month performance, due to the uncertainty of the stability of the current trend. The current projection assumes 0% growth over FY 2010 performance for the remaining months of the fiscal year. As more data is available, demonstrating consistent performance improvements, the forecast should be adjusted accordingly.

Other Major Revenues

The FY 2011 General Fund Year-End Revenue Projections Report also updates projections for franchise fees, safety sales tax, property transfer tax, and VLF. The IBA agrees with the adjustments to franchise fees, safety sales tax, and VLF, with some concerns with the property transfer tax. With current housing data relaying a flattening out and possible reduction in home prices, and a recent slowing in sales activity that can lead to even more downward pressure on housing prices, it is likely that property transfer tax collections will come in less than budget.

Given the limited information available regarding the performance of these revenues with only a few months of performance data available, the adjustments in the projections for them are conservative in only reflecting improvements or declines in actual performance data. As more information is available, revealing trends, the projections will have to be adjusted accordingly. In the case for franchise fees, any major changes in the projection would not take place until after the February quarterly payments are received from SDG&E and cable franchises.

Parking Meter Utilization Plan

As a budget solution proposed in December 2009, the FY 2011 Budget includes \$2.6 million in additional revenue attributable to a change in parking meter pricing. Based on the results of a parking utilization study and staff estimates, this additional and on-going revenue was expected from a change to variable rate pricing and flexible operating hours. Staff was to return to the City Council with an ordinance to authorize changes to parking meter pricing; however, the ordinance has yet to come forward. Staff has informed the IBA that they are planning to bring an ordinance forward for City Council consideration in January 2011. Given this timeframe and assuming time will be required for implementation/adjustments, the IBA believes it is increasingly unlikely that much, if any, of the estimated \$2.6 million will be realized in FY 2011.

Impact to FY 2012

The Five-Year Financial Outlook will have to be modified to reflect changes in the FY 2011 base for the forecast, in addition to changes in the growth rate assumptions for the forecast years based on current revenue performance and economic data. The Mayor's revised Five-Year Financial Outlook is expected to be released in January 2011. At this time, it is premature to assess the overall impact of the projected \$8.6 million positive variance in FY 2011 revenues on FY 2012. Additional information is needed not only on the revenue categories reviewed in the report, but for other revenue categories not included which comprise approximately 34% of the FY 2011 Budget.

CONCLUSION

In general, the IBA concurs that the adjustments presented in the FY 2011 General Fund Year-end Revenue Projections Report are appropriate for now given current performance data and the economic outlook. It is important to note that the revenue update does not provide a comprehensive review of the General Fund revenue performance. Due to the timing of receipts and also current SAP accounting issues, not enough data is available to provide an update on all General Fund revenues, particularly departmental revenues. In FY 2010, declines in departmental revenues accounted for 42.7% of the projected revenue performance under budget as of the year-end report. The impact of possible fluctuations in the performance of these revenues is unknown, and a full assessment will not be available until late February 2011 with the release of the Mid-Year Budget Monitoring Report.

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